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CHARLES ELBERT COOPLY
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1940

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIFPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

BRIEF FOR PETITIONERS.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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INDEX.

	PAGE
I. Opinions Below	1
II. Jurisdiction	1
III. Statement of the Case.....	2
IV. Specification of Errors	7
V. Summary of Argument	8
VI. Argument	10
A. The Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a) Requires the Trustees to Pay All State Taxes Lawfully Assessed Against the Underliers.....	10
B. As a Matter of General Law, the Federal as Well as the State and Local Taxes Assessed Against the Underliers Should be Paid by the Trustees.....	15
C. The Taxes of the Underliers Which Became Payable After Approval of the Debtor's Original Petition Should Be Paid by the Trustees Regardless of the Date of Accrual of Such Taxes.....	21
D. Payment of the Taxes of the Underliers by the Trustees Should Not Be Dependent Upon a Separate Determination of the Net Income Derived From the Properties of Each Underlier. Payment of the Underliers' Taxes Will Not Result in Objectionable Preferences	23
VII. Conclusion	27

Index.

Cases Cited.

	PAGE
American Brake Shoe & Foundry Co., 282 Fed. 523...	24
Bear River Paper & Bag Co. v. City of Petoskey et al., 241 Fed. 53.....	15, 17
Boteler v. Ingels, 308 U. S. 57, 84 L. Ed. 20.....	15
In Re Chase Commissary Corp., 11 Fed. Supp. 288..	15
Continental Illinois Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648, 77 L. Ed. 1110	21
Coy v. Title Guarantee & Trust Co., 220 Fed. 90...	15, 16
Hardee et al. v. American Security & Trust Co., 77 Fed. (2d) 382.....	16
MacGregor v. Johnson-Cowdin-Emmerich, Inc., 39 Fed. (2d) 574	16
Michigan v. Michigan Trust Co., 286 U. S. 334, 76 L. Ed. 1136	15, 16
Nebbia v. People of State of New York, 291 U. S. 502; 78 L. Ed. 940	15
North Kansas City Bridge & Railroad Co. v. Leness, 82 Fed. (2d) 9	25
Palmer v. Palmer, 104 Fed. (2d) 161.....	15
In Re Schulte Retail Stores Corp., 22 Fed. Supp. 612	25
Warren v. Palmer, 310 U. S. 132; 84 L. Ed. 752.....	26
Webster & Atlas National Bank v. Palmer, 111 Fed. (2d) 215	27
Westinghouse Electric & Manufacturing Co. v. Brooklyn Rapid Transit Co., 6 Fed. (2d) 547...	24

Statute Cited.

Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a)	10
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Committee, and CITY OF PITTSBURGH, Respondents.**

BRIEF FOR PETITIONERS.

I.

OPINIONS BELOW.

The opinion of the District Court (McVicar, J.) has not yet been officially reported; it appears at pages 78 to 83 of the record, fols. 107 to 113. The opinion of the Circuit Court of Appeals (Maris, C.J.) is reported in 111 Fed. (2d) 932, and will be found at pages 104 to 110 of the record, fols. 147 to 153.

II.

JURISDICTION.

The Circuit Court of Appeals entered its orders on April 30, 1940 (R. 110; fols. 154, 155). On June 12, 1940 said orders were vacated (R. 111, 112; fols. 156, 157), and amended orders were entered (R. 112, 113; fols. 158,

159). No petition for rehearing was filed. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chap. 229, § 1, 28 U.S.C.A. § 347, since this is a cause on which final orders of a Circuit Court of Appeals have been entered. The petition for writs of certiorari was filed on July 15, 1940, and the writs were granted October 14, 1940 (R. 115).

III.

STATEMENT OF THE CASE.

Since 1902 Pittsburgh Railways Company (hereinafter sometimes referred to as the "debtor") has been in possession of and has occupied, used and held properties of approximately 55 street railway companies (hereinafter referred to as "underliers") which properties in conjunction with its own properties, the debtor has operated as a unified street railway transportation system in and about the City of Pittsburgh, Pennsylvania, the system being known as the Pittsburgh Railways System (R. 6, 7, 41, 62). The underliers' properties were in possession of the debtor under certain leases and operating agreements which require the debtor to pay expenses of operation and ordinary maintenance and all taxes of the underliers (R. 7).

The Pittsburgh Railways System consists of approximately 560 miles of track, incline plane properties, cars and buildings used primarily for the housing of cars. The debtor itself owns 28 miles of track, cars and other miscellaneous property (R. 79). The debtor has always paid, directly, the expenses of operation and ordinary maintenance and all taxes of the underliers. None of such payments have been made by the underliers (R. 7).

On May 10, 1938, the debtor filed a voluntary petition to effect a plan of reorganization under the provisions of Section 77B of the Bankruptcy Act, and on the same day the court approved the petition as properly filed and continued the debtor in possession with authority to operate its business (R. 6). By order entered June 14, 1938, the court appointed trustees of the debtor and its subsidiary, Pittsburgh Motor Coach Company, and authorized the trustees, *inter alia*, to

“preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business; and without limiting the generality of the foregoing, to collect and receive the income, rents, revenues, tolls, issues, and profits of said property and estate; * * * and to pay all taxes and assessments due or to become due upon the property in possession and/or owned by the debtor.” (R. 6).

Pursuant to their authority the trustees have since their appointment and qualification been operating the business of both debtor and the subsidiary, using in their operation the properties of the underliers (R. 45). However, the trustees have neither affirmed nor disaffirmed the leases and operating agreements between the debtor and its underliers (R. 62).

On March 10, 1939, the trustees of the debtor filed a petition with the District Court praying for instructions with respect to the payment of taxes of the underliers which became due and payable after the approval of the debtor's original petition (May 10, 1938), together with certain other taxes of the debtor and its subsidiary not material herein (R. 6-20). The taxes of the underliers

concerning which the trustees sought instructions are set forth below.* The trustees' petition averred that at the date of filing the original petition, the cash on hand was \$230,260.00, and on March 8, 1939, was \$1,537,247.46, the latter amount being sufficient to pay all taxes as to which instructions were requested by the trustees (R. 12). None of the underliers had funds with which to pay any of the taxes assessed against them (R. 13).

The trustees' petition was referred to a special master for hearing and a report thereon (R. 21). At the hearing objections to the payment of the taxes of the underliers were filed by the Tort Creditors' Committee of the debtor (R. 21, 22). Mr. Fitzgerald, one of the trustees who has been in active charge of the operation of the Pittsburgh Railways System since 1924, testified at the hearing that (a) since it was created in 1902 there has been absolutely no effort to account for revenues and operating expenses of individual underliers; (b) to attempt to account for revenues and operating expenses of individual underliers would be tremendously expensive, and the results would not furnish a dependable basis for allocating revenues; (c) the only way in

*Unpaid balances of Federal income taxes for the year 1937, payments due June 15, September 15, and December 15, 1938	\$ 97,412.14
Federal income taxes for the year 1937, withheld at source in respect to interest upon obligations of underliers, payment due June 15, 1938.....	6,850.01
Pennsylvania corporate net income taxes for the year 1937, payment due May 15, 1938.....	27,639.59
Federal income taxes for the year 1938.....	50,501.26
Federal income taxes for the year 1938, withheld at source with respect to interest upon obligations of underliers.....	2,668.08
Pennsylvania corporate net income taxes for the year 1938....	18,335.72
Pennsylvania capital stock taxes for the year 1938.....	64,294.57
Pennsylvania corporate loans taxes for the year 1938 in respect to interest upon the obligations of underliers.....	17,502.56
Total.....	\$285,203.93

which net earnings of each underlier could be determined would be to operate each individually, such individual operation being physically impossible and unsatisfactory to the public and to municipal and state authorities; and (d) at present he knows of no method of determining what relative rentals should be paid to the various underlying companies whose properties have been utilized by the debtor or its trustees since May 10, 1938 (R. 40-43). Mr. George, one of the trustees charged with the duty of preparing a plan of reorganization, testified that (a) he believes there will not be a great amount of abandonment of properties of the underliers in the reorganization; (b) he did not consider it practicable for the trustees to say what properties of the underliers will or will not be embraced in the contemplated plan of reorganization; and (c) the properties of the underliers whose taxes were being considered are presently being operated by the trustees (R. 45-47).

The special master filed a report recommending, *inter alia*, that the taxes of the underliers should not be paid by the trustees (R. 67, 68). Exceptions were filed to the special master's report by Philadelphia Company (petitioner herein and principal creditor of and owner of all the capital stock of the debtor), and by certain underliers listed below,* also petitioners herein (R. 72-

* Allegheny, Bellevue and Perrysville Railway Company; The Allentown and Roscoe Electric Street Railway Company; Ben Avon and Emsworth Street Railway Company; Bon-Air Street Railway Company; Cedar Avenue Street Railway Company; East McKeesport Street Railway Company; Glenwood and Dravosburg Electric Street Railway Company; The McKeesport and Reynoldton Passenger Railway Company; Mt. Washington Street Railway Company; Mt. Washington Tunnel Company; Pittsburgh, Allegheny, and Manchester Passenger Railway Company; The Pittsburgh, Allegheny and Manchester Traction Company; Pittsburgh and Charleroi Street Railway Company; Pittsburgh and West End Railway Company; Pittsburgh, Canonsburg and Washington Railway Company; Pittsburgh, Crafton and Mansfield Street Railway Company; Pittsburgh, Neville Island and Coraopolis Railway

78). An argument on the exceptions of your petitioners herein was held before the District Court and, subsequent thereto, counsel for the trustees filed a statement with the District Court recommending the payment of all taxes of the underliers, except Federal income taxes in so far as such income taxes were produced by payments made to the underliers by Philadelphia Company in discharge of its obligations as guarantor of the underliers' lease covenants and except Pennsylvania corporate net income taxes unless and until the liability of the underliers for such taxes should be determined (R. 93-101).

The District Court entered its opinion and order holding and directing that the underliers' taxes be paid to the extent recommended by counsel for the trustees (R. 78-86). From said order of the District Court, in so far as it directed payment of the underliers' taxes, the Tort Creditors' Committee and the City of Pittsburgh appealed to the Circuit Court of Appeals for the Third Circuit (R. 86, 87). The appeals were heard together, and in its opinion filed April 30, 1940, the Circuit Court of Appeals reversed the District Court (R. 104-110). The orders of the Circuit Court entered April 30, 1940 (R. 110) were vacated and amended orders entered June

Company; Pittsburgh Union Passenger Railway Company; Second Avenue Passenger Railway Company; Second Avenue Traction Company; The Second Avenue Traction Company; Superior Avenue and Shady Avenue Street Railway Company; United Traction Company of Pittsburgh; Washington and Canonsburg Railway Company; West End Traction Company; West Liberty and Suburban Street Railway Company; West Shore Electric Street Railway Company; Consolidated Traction Company; Ardmore Street Railway Company; Central Passenger Railway Company; The Central Traction Company; Fort Pitt Traction Company; The Pittsburgh Traction Company; The Duquesne Traction Company; The Duquesne Street Railway Company; Federal Street and Pleasant Valley Passenger Railway Company; The Morningside Electric Street Railway Company; Seventeenth Street Incline Plane Company.

12, 1940 (R. 111-114), in which it was directed that the order of the District Court be reversed in so far as it directed the payment of taxes involved in the appeals. Petitions for writs of certiorari to review the judgments of the Circuit Court were filed on July 15, 1940, and writs of certiorari were granted October 14, 1940 (R. 115).

IV.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In reversing the order of the District Court.
2. In holding that the taxes of the underliers which became due and payable after the approval of the debtor's original petition should not be paid by the trustees of the debtor.
3. In holding that the taxes of the underliers which accrued after the approval of the debtor's original petition should not be paid by the trustees of the debtor.
4. In requiring payment, in violation of the Fifth Amendment to the Constitution of the United States, of the debtor's taxes out of funds in the possession of the trustees derived largely from the operation of the underliers' properties while forbidding any payment of the underliers' taxes from those funds.
5. In holding that the court must first determine the property of the underliers which is being used, the extent of its use and the net earnings being derived from it or its value before any payment to the underliers on account of use and occupation can be permitted.
6. In holding that the only obligation of the debtor or of the trustees to pay taxes of the underliers is by virtue of covenants in the leases and operating agree-

ments under which the debtor was in possession of the properties of the underliers.

7. In failing to treat the taxes of underliers as operating expenses entitled to payment as expenses of administration.

8. By failing to give proper effect to the Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A., Sec. 124a).

V.

SUMMARY OF ARGUMENT.

The Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A. Sec. 124a) directs that any trustee appointed by any United States court, who is authorized by said court to conduct any business, or who does conduct any business, shall be subject to all state and local taxes applicable to such business. The trustees of the debtor are appointees of a United States court and as such are conducting the business of the underliers. Therefore, under the provisions of Sec. 124a they should be required to pay all state and local taxes applicable to the underliers' business. Furthermore, if the Act of June 18, 1934 be narrowly confined to taxes of the debtor itself regardless of the fact that the trustees are also operating the underliers' business, it would be arbitrary, capricious and unreasonable and would violate the Fifth Amendment to the Constitution.

It is a well established general principle that it is the duty of trustees or receivers to pay all taxes, including federal taxes, applicable to the business conducted by them as if such business were conducted by an individual or corporation; and such taxes have been accorded priority whether or not they are a lien upon the property of the debtor. This principle, although announced in cases where the taxes in question were the

taxes of the debtor or bankrupt itself, is equally applicable to taxes levied against underliers so long as their business is being operated by the debtor's trustees. No case has ever required that this principle be narrowly confined to taxes of the debtor itself, and the reasons underlying this principle make it applicable to the underliers' taxes.

All taxes which accrued or became due and payable subsequent to the filing of the debtor's original petition should be paid by the trustees. No technical distinctions should be made on the basis of the date of accrual of the taxes.

Payment of the taxes of the underliers should not be dependent upon separate ascertainment of the net revenue derived from the use of the properties of the respective underliers. The taxes in question should be paid as part of the operation expenses of the trustees. They are not payable solely by virtue of the provisions of the operating agreements and leases. Our position is that the trustees have the duty, independent of any contract, to pay the taxes accrued on the business of the underliers while that business is operated by the trustees. We are not concerned with the trustees' duty to make payments to the underliers under the leases and operating agreements but with the trustees' duty to pay taxes to the sovereign assessing those taxes in respect of business conducted by the trustees.

Even if the only obligation upon the trustees to pay the taxes in question were derived from the leases and operating agreements, the respondents have no cause for complaint. The funds in the hands of the trustees available for the payment of the underliers' taxes are derived almost entirely from the operation of the underliers' business and property, and therefore the underliers have a prior claim upon these funds, either as rent

payments, if the leases and operating agreements be affirmed, or for use and occupation, if rejected. For that reason, if the payment of underliers' taxes were to result in preferences, such preferences would be preferences between the underliers themselves and not preferences of the underliers over any other creditors.

Furthermore, even on the respondent's erroneous assumption that payment of taxes are justified only as allowances for use and occupation, orderly administration of the estate requires that taxes be paid by the trustees as they fall due. The trustees may be completely protected by an order giving the trustees a prior lien on the property of each underlier, in the event of the rejection of the lease of that underlier, to the extent of the excess of the taxes paid on such property over a reasonable allowance, if any, for use and occupation.

VI.

ARGUMENT.

- A. The Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A. Sec. 124a) Requires the Trustees to Pay All State Taxes Lawfully Assessed Against the Underliers.**

The Act of June 18, 1934, 48 Stat. 993 (28 U.S.C.A. Sec. 124a) provides as follows:

"Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after the enactment of this Act, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: *Provided, however,* That nothing in this section contained shall be construed to prohibit or prejudice the collection

of any such taxes which accrued prior to the approval of this Act, in the event that the United States court having final jurisdiction of the subject matter under existing law should adjudge and decide that the imposition of such taxes was a valid exercise of the taxing power by the State or States, or by the civil subdivisions of the State or States imposing the same."

By order of the District Court, entered June 14, 1938, the trustees of Pittsburgh Railways Company were authorized, *inter alia*, to " * * * operate * * * the property and assets in possession of and/or owned by the debtor." (R. 6) The trustees are operating the business of the underliers under authority of this order. Nevertheless, the court below, without any reference to Sec. 124a, the applicability of which was urged upon it, held that the trustees should not pay state taxes of the underliers despite ample funds in the trustees' hands derived largely from the operation of the business of the underliers.

The effect of the Circuit Court's decision is to confine the application of Sec. 124a to taxes assessed in respect of the business of the particular debtor corporation although the order of court appointing the trustees, may authorize or direct such trustees to continue the operation of the business of other corporations previously operated by the debtor under lease or other operating agreement in conjunction with its own business as a unit, and has the effect of exempting the trustees from the payment of any taxes assessed in respect of the business of such other corporations. Such a construction of Sec. 124a is too narrow.

The Act requires only that the taxes in question be taxes applicable to a business being conducted by trustees appointed by a United States court. Those condi-

tions being met, the taxes must be paid. The present case falls squarely within the boundaries of this Act.

The trustees were appointed by a United States court, and as such appointees are operating the business of the various underliers. Pursuant to certain leases and operating agreements, Pittsburgh Railways Company has, since 1902, been in possession of and has used and operated the properties and franchises of the underliers in conjunction with its own as a unified street railway transportation system (R. 6, 7, 41, 45, 62). Pursuant to the order of court of June 14, 1938, referred to above, the trustees have continued the operation of the business of the debtor and the underliers (R. 45). They have operated the properties and have used and enjoyed the rights, privileges and franchises (except the bare franchise to be a corporation) of each of the underliers. There is no problem here as to whether one corporation should be liable for the obligations of another. The question of maintaining separate corporate entities is not involved. The trustees are as fully possessed of the properties of the underliers as of the property of the debtor. The underliers have no other business and after the trustees of the debtor took possession of their properties the underliers became a mere corporate shell with no assets to use in operating any business whatsoever and with no opportunity to operate a business. The trustees are not possessed of or exercising the franchise to be a corporation of either the debtor or the underliers. The trustees have not affirmed or rejected the leases and operating agreements (R. 62). Accordingly, their operation of the properties of the underliers has not been as lessees or by virtue of any other contract, but solely as agents of the District Court under authority of the aforesaid order of court. It cannot be doubted that, as such, they are actually operating the business of the underlying street railway companies as fully as they are operating the business of the debtor itself. The under-

liers, in fact, are not presently in a position to operate their own business (R. 66). They have no funds, no operating personnel and no rolling stock. As stated by the Special Master appointed by the District Court in this proceeding:

"It is the duty of a common carrier to furnish and operate 'a reasonably sufficient number of safe facilities, and run and operate the same with such motive power as may reasonably be required, in the transportation of all such passengers or property as may seek, or be offered to it, for such transportation * * *': Pennsylvania Act of May 28, 1937 P. L. 1053, Section 403, *Purd. Pa. Digest*, Title 66 Section 1173. This duty of the underlying companies which own the tracks and franchises has been performed by Pittsburgh Railways Company or its receivers or trustees since 1902. The underlying owner companies are not presently prepared to resume the performance of their duty to the public. Even if they had the necessary capital, cars and personnel, their several properties have for a generation been operated as a unit and by force of circumstances the operation of many of them has become dependent upon the operation of others of them. It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated." (R. 65, 66)

It also follows from what has been said that the taxes in question are "applicable to such business" (i. e.

the business operated by the trustees). The taxes in question come into existence solely by reason of the operation of the business operated by the trustees and depend upon the continuance of that business for payment. Furthermore, the non-payment of these taxes, by reason of the imposition of onerous penalties and interest and the possibility of distraint proceedings by the taxing authorities, may hinder or obstruct the operation of the business operated by the trustees. And finally, the effect of non-payment of the taxes will be to lessen the value of the property available for inclusion in a plan of reorganization. Since the whole purpose of the bankruptcy proceedings is to foster the preparation of a plan of reorganization, any tax the non-payment of which tends to thwart that purpose should be held to be "applicable to" the business conducted by the trustees.

The trustees are appointees of a Federal Court who, subsequent to their appointment and qualification, have been operating the business of the underliers. They should be required, under the provisions of Sec. 124a, to pay the state taxes applicable to such business.

A further reason for construing Sec. 124a to require the payment of the taxes in question is that, unless the statute be so construed, it is unconstitutional as depriving the underliers of their property without due process of law in violation of the Fifth Amendment of the Constitution of the United States. It is elementary that an unconstitutional construction will be avoided wherever possible. The effect of Sec. 124a must be viewed in the light of a case, such as the present, in which the trustees are operating not only the property of a debtor, but the property of underliers as well. Congress must have contemplated that the trustees would take a "breathing spell" within which to determine whether to adopt or reject the leases of

the underliers. *In re Chase Commissary Corporation*, 11 Fed. Supp. 288; *Palmer v. Palmer*, 104 Fed. (2d) 161. If, during this "breathing spell", Sec. 124a be construed to permit the imposition of the liens of taxes, penalties and interest upon the properties of the underliers, and the consequent deprivation of the property of the underliers, its operation is arbitrary and discriminatory and not related to the legislative purpose, namely, the orderly and equitable administration of insolvent estates, and it would therefore, if so construed, be unconstitutional. *Nebbia v. People of State of New York*, 291 U. S. 502, 537; 78 L. Ed. 940. The underliers are entitled to have their property preserved while it remains in the hands of the trustees. If the underliers' property is returned to them, subject to the burdens, not only of taxes, but of penalties and interest, and if at the same time the property of the debtor itself is preserved intact, it is apparent that Sec. 124a, in its practical operation, is arbitrary, capricious and discriminatory.

R. As a Matter of General Law, the Federal as Well as the State and Local Taxes Assessed Against the Underliers Should Be Paid by the Trustees.

In all cases decided by this Court and by the lower Federal Courts relating to the payment of taxes by trustees or receivers, it has been held, as a general principle of law, that it is their duty to pay all taxes applicable to the business conducted by them as if such business were conducted by an individual or a corporation; and such taxes have been accorded priority, as expenses of the administration, whether or not they are liens upon the property of the debtor. *Michigan v. Michigan Trust Co.*, 286 U. S. 334, 76 L. Ed. 1136; *Boteler v. Ingels*, 308 U. S. 57, 84 L. Ed. 20; *Coy v. Title Guarantee & Trust Co.*, 220 Fed. 90; *Bear River Paper & Bag*

Co. v. City of Petoskey et al., 241 Fed. 53; *MacGregor v. Johnson-Cowdin-Emmerich, Inc.*, 39 Fed. (2d) 574; *Hardee et al. v. American Security & Trust Co.*, 77 Fed. (2d) 382. In all of these cases the taxes in question were the taxes of the debtor or bankrupt corporation itself. However, it is submitted that the general principle is applicable to the present case and that the trustees should be required to pay the taxes assessed in respect of the business of the underliers so long as the business of such underliers is being operated by the debtor's trustees in conjunction with the debtor's business.

In *Michigan v. Michigan Trust Co.*, 286 U.S. 334, 76 L. Ed. 1136, it is said:

"* * * Taxes owing to the Government, whether due at the beginning of a receivership or subsequently accruing, are the price that business has to pay for protection and security."

In *Coy v. Title Guarantee & Trust Co., et al.*, 220 Fed. 90, it is stated:

"It is too clear for argument that the appointment of a receiver and the taking of property into the hands of the court through its officer does not withdraw it from taxation. It remains subject to assessment and to the payment of all legal taxes thereon while in custodia legis, to the same extent as it was while in the possession of the owner. And whether or not such taxes be a lien or a debt by the laws of the government within whose jurisdiction the property is situated, such taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims, for they are essential to the existence and maintenance of the very government under which the property is acquired and protected.

" 'A court', said Cooley on *Taxation* (3d Ed.) Vol. 2, p. 834, 'having in its charge or under its control a fund or other property upon which taxes are due, will, as the representative of the sovereignty, direct them to be paid without raising any question of the means of enforcement by process, and before all other claims except judicial costs. Thus upon proper application and suitable proof a receiver will be ordered to satisfy a tax assessed against the property in his hands, and a like direction will be made in other cases where funds are held subject to the authority of the court.' "

In *Bear River Paper & Bag Co. et al. v. City of Petoskey et al.*, 241 Fed. 53; it is stated:

"We think it unnecessary to decide the question of lien. These taxes were owing to the state, the county, and the city as the consideration for governmental benefits enjoyed by this property and this business during three years. The property has been in possession of the receivers, and the business has been conducted by them. It is not claimed that any other tax has been assessed in this state against them, or against the property, or against the mortgagor, or mortgagee, or mortgage bondholders. It might have been assessed against the receivers, for C. L. Sec. 3837 (6) says:

" 'Personal property mortgaged or pledged shall be deemed the property of the person in possession thereof, and may be assessed to him.' "

"It is not claimed that the taxes are unjust or in any way inequitable. Under these conditions, and even if it were to be assumed that the taxes had not become a lien against the property, or that, through the mistake of the assessing officers, no enforceable debt against the receivers had arisen, a due regard for the rightful burdens of all citizens and residents

toward the state government, and a due recognition of benefits received should impel a federal court to direct its receiver to make payment. Such payment, in the absence of a meritorious objection to the tax, we regard as the receiver's clear duty; and so it has been held, in substance, if not specifically. In *Re Tyler*, 149 U.S. 164, 187, 13 Sup. Ct. 785, 37 L.Ed. 689; *Coy v. Title Co.* (C.C.A. 9) 220 Fed. 90, 92, 135 C.C.A. 658, L.R.A. 1915E, 211."

The basis for the general rule established by these cases is that taxes should be paid as the consideration for the governmental benefits enjoyed by the property or business in respect of which such taxes are assessed. It is for this reason that the above cases have held that receivers and trustees in possession of and operating a business should be required to pay taxes assessed in respect of that business in preference to other claims.

When the reason for the rule is thus understood, it is clear that the rule itself should be applied as well to taxes levied against the underliers so long as the business of such underliers is being operated by the debtor's trustees.

In the present case, the street railway properties used and operated by the trustees have been operated since 1902 as a unified system, and all of the revenues therefrom have been kept in a single fund without attempting to account for the revenues or earnings of the various companies comprising the system. There is no dependable basis for allocating revenues. This could be determined only by operating each underlier separately, which is a physical impossibility. (R. 40, 41, 42, 43). The properties operated in the unified system consist almost entirely of the properties of the underliers (R. 79), and the funds in the hands of the trustees represent, for

practical purposes, the earnings of the trustees from the use and operation of the underliers' properties. The funds in the hands of the trustees are more than ample to pay all the taxes here in question (R. 12). None of the underliers has funds with which to pay any of the taxes assessed against them (R. 13). It is expected that the system will be reorganized as a unit and that there will not be any great amount of abandonment of the properties of underlying companies (R. 45). Under such circumstances the District Court held that the rule laid down in the above authorities should be applied to this case, thus requiring the trustees to pay out of the earnings of the unified system, all taxes of the underliers incurred as a result of the operation of their properties. The trustees pursuant to the order of the District Court entered June 14, 1938 (R. 78-83). The Circuit Court of Appeals held otherwise, refusing to permit payment of the underliers' taxes on the ground that such payments could not be justified either as rent payments, in the absence of a precise ascertainment of the revenues derived from or fair value of each separate underlier's property (an admittedly impossible task), as payments on account of use and occupation of the underliers' properties (R. 104-110).

It is submitted that the decision of the District Court was correct and that the Circuit Court of Appeals erred in reversing that decision. Having taken possession of the underliers' properties, the trustees should be required to take them *cum onere*, and the taxes here in question, arising as a result of the operation of the business of the underliers, should be held as much a part of the trustees' expenses as current upkeep. Operating expenses refer to charges for ordinary maintenance and should include any charges necessary to preserve the property in question, pending the formulation of a plan of reorganization.

As stated by the Special Master appointed by the District Court to report upon the trustees' petition with respect to the payment of the underliers' taxes:

"It can hardly be doubted that the separate operation of many of the properties of the several owners would be impracticable. Although the underlying companies themselves are not in bankruptcy or reorganization, their properties in reality are in reorganization to the extent that they are in the possession of the trustees, will probably be involved somehow in the reorganization of Pittsburgh Railways Company if any reorganization is effected, and are being operated." (R. 66)

Taxes are intensely practical. In substance, all of the properties in the possession of the trustees are in reorganization and must be given the same consideration as the properties of the debtor for the purpose of working out a reorganization, for which reason it is necessary that all taxes be paid.

As stated by the District Court, after reviewing the above cases:

"The rule laid down in the above authorities should be applied to taxes levied against the underliers in this case. The system is a unit; it is proposed to reorganize it as a unit; the fund from which the taxes are to be paid arise from this unit; the taxes must be paid ultimately; interest and penalties are accruing by reason of non-payment; the taxes 'are the price that business has to pay for protection and security'; 'taxes are and should be regarded by the courts as a preferred and paramount claim over all other claims.' The same rule should be applied to State and Federal taxes as applies to local taxes. Taxes legally levied against the

underliers and which became due and payable after the approval of the original petition are an administration expense and should be ordered paid, subject to the qualification in the decree filed herewith." (R. 83)

The District Court was correct in treating the development and consummation of a plan of reorganization as its dominant consideration. The whole purpose of the reorganization proceedings, and the purpose of the rule permitting the trustees to retain leased property pending an affirmance or disaffirmance of the underliers' leases, is to facilitate preparation of a plan of reorganization. The court should preserve intact all of the property in its possession as long as there remains any possibility that the property will be used in the consummation of a plan of reorganization. *Continental Illinois Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U.S. 648, 77 L.Ed. 1110. As long as the properties are retained by the trustees there remains the possibility that they will be retained in the plan of reorganization. This possibility justifies, and requires, the payment of the taxes.

C. The Taxes of the Underliers Which Became Payable After Approval of the Debtor's Original Petition Should Be Paid by the Trustees Regardless of the Date of Accrual of Such Taxes.

Of the taxes of the underliers involved in this appeal, in the case of Federal income taxes for the year 1937, the return was required to be filed on March 15, 1938, and one-fourth of the tax shown on the return was required to be paid on March 15, 1938, and the payment of the balance of such tax was required in three equal installments on June 15, September 15, and December 15, 1938; in the case of Pennsylvania corporate net in-

come taxes for the year 1937, the return was required to be filed on April 15, 1938, and one-half of the tax shown on the return was required to be paid on April 15, 1938, and the balance thereof on May 15, 1938. On May 10, 1938, the debtor filed its petition which was prior to the time when the said June, September and December installments of Federal income taxes and the said May installments of Pennsylvania corporate net income taxes became due and payable.

The court below said (R. 107) :

"Even though the taxpayer was given the option to pay these taxes in installments, the taxes were actually due on the dates mentioned (March 15, 1938 and April 15, 1938, insert ours), which were the dates fixed by law for filing the tax returns. The failure of the debtor to pay these taxes was a breach of the leases and operating agreements and the amounts then due became simple contract claims against the debtor, due when the debtor's petition was filed. As to these claims the underliers must take their position with all other general creditors."

The debtor's obligation under the leases and operating agreements was to pay the taxes when payment was due the Federal government, namely, one-fourth of the tax on March 15, 1938 and the balance in three equal installments on June 15, September 15, and December 15, 1938. Therefore, the debtor had not breached its contract and the underliers had no cause of action against the debtor prior to the filing of the debtor's original petition. The liability of the debtor did not ripen until subsequent to the filing of its petition, or, in other words, until the June 15, 1938 installment became due and payable to the Federal government. So long as the debtor's trustees were operating the business of the underliers when these taxes became a liability of such trustees, they should be paid.

D. Payment of the Taxes of the Underliers by the Trustees Should Not Be Dependent Upon a Separate Determination of the Net Income Derived From the Properties of Each Underlier. Payment of the Underliers' Taxes Will Not Result in Objectionable Preferences.

The respondents' position and the decision of the court below are based upon the assumption that the only obligation of the trustees to pay the taxes here in question is a contractual one under the provisions of leases and operating agreements pursuant to which the properties of the underliers were operated by the debtor. On that premise their position is that until the leases and operating agreements are affirmed or disaffirmed, the only obligation of the trustees to the underliers is to pay an amount for use and occupation of their properties measured by the use, extent of its use and the net income therefrom and that, since it is impossible to determine separately the net revenue derived from the operation of each underlier's properties, no allowance can be made, by tax payment or otherwise, in order that there may be no preference of the underliers over other creditors.

This is entirely too narrow a view. It loses sight of the true reason why these taxes should be paid. The trustees themselves state:

"We do not contend these taxes are payable because the debtor contracted to pay them. While such contracts exist, thus far the Trustees have not affirmed them and may never do so. Whatever might be the effect of affirmance of the operating agreements and leases on the obligation of the Trustees to the underliers, we submit that the obligation of

the Trustees to the taxing authorities is not governed by those contracts or by any action that might be taken by the Trustees with respect to them. Nor do we contend these taxes are payable as compensation for use and occupancy of the underliers' properties by the Trustees." (R. 106, note 3)

As we have stated above, these taxes are payable as part of the consideration for the protection and security afforded by the sovereign imposing the taxes to the business and properties being operated by the trustees. Such are operating expenses of the very highest character. There is no question here involved concerning the underliers' right to receive a return upon their properties. The respondents make their error in viewing this case as if it involved a demand for a payment to the underliers. The underliers do not seek any return for themselves. All they ask is that they be not deprived of their property by the imposition of tax liens.

However, even on the narrow premise assumed by the respondents that the trustees' obligation to pay the underliers' taxes is based upon the leases and operating agreements we cannot accept their conclusions. Mr. George, a co-trustee, testified that all of the properties of the underliers are being used. A study of the authorities in which it is announced that allowances to underliers are dependent upon a separate determination of net revenues from their properties indicates that this principle has application only to cases where the earnings are susceptible of determination with reasonable accuracy. It was a measure used in those particular cases for determining the amount payable to the lessors for the use and occupancy of their properties. *American Brake Shoe & Foundry Co.*, 282 Fed. 523; *Westinghouse Electric & Manufacturing Co. v. Brooklyn Rapid Transit*

Co., 6 Fed. (2d) 547. In *North Kansas City Bridge & Railroad Co. v. Leness*, 82 Fed. (2d) 9, where the receiver actually made payments to the lessor for use and occupancy of the property prior to disaffirming the lease, the court said:

"Undoubtedly the receiver and the court below continued the unprofitable operation of the line in the hope that times and conditions might so change that a purchaser could be found for it as a going concern, or that the company might in some way be reorganized.

* * * * *

"The theory of the bondholders' committee that the Bridge Company is entitled to nothing is based on cases all of which involve the rental of extensive railway trackage constituting more or less complete transportation systems of themselves, the separate earnings of which were determinable with reasonable accuracy, and the use of which trackage was shown to have produced nothing for the receiver."

It is submitted that the legal principle advanced by respondents has no application here where the separate earnings of the respective underliers are not susceptible of determination with reasonable accuracy.

The fear of preferences of underliers over other creditors is also without foundation. The funds in the hands of the trustees available for the payment of the underliers' taxes represent, for all practical purposes, the earnings of the trustees from the use and operation of the business and properties of the underliers (R. 65). These funds are subject to the prior claims of the underliers either as rental if the leases and operating agreements should be affirmed, or for use and occupation if rejected. As said in *In Re Schulte Retail Stores Corp.*, 22 Fed. Supp. 612, 615:

"* * * If the lease were affirmed, the liability would be considered as one for rent; if the lease were rejected, the liability would be for use and occupancy, viz., the reasonable value of the use of the premises which, in turn, would probably be the rent specified in the lease. *Irrespective of the legal characteristics of the liability, it would be recognized as an expense of reorganization and, as such, it would enjoy priority over claims that accrued prior to the inception of these proceedings.*" (Italics ours)

If therefore, any preference would result from payment of the underliers' taxes out of these funds, it would be a preference between the underliers themselves and would not injure any of the parties who are objecting to these payments. The underliers themselves have not objected and would be estopped to make any claims by reason thereof.

Finally, and still assuming the respondents' erroneous contention that payments of taxes are justified only as allowances for use and occupation, it does not follow that the payment of taxes should be deferred. Orderly administration of the estate requires that the taxes of underliers be paid as they fall due (thereby avoiding the liens of penalties and interest, and avoiding inconvenience to the taxing authorities) and that the rights of the parties be adjudicated by later proceedings or in the plan of reorganization. The trustees could be completely protected by an order, entered at the time of the payment of the taxes, similar to the order entered in the New York, New Haven & Hartford reorganization, and tacitly approved by this court. *Varren v. Palmer*, 310 U. S. 132, 135, 136; 84 L. Ed. 752. Such an order would provide that, in the event of the rejection of the lease of an underlier, the trustees should be entitled to a prior lien on the property of such an underlier to the

extent of the excess of the taxes paid on such property over a reasonable allowance, if any, for use and occupation.

Such an order would completely protect the trustees. If the lease of a given underlier is adopted, or if its property is included in the plan of reorganization, the trustees cannot complain of having paid the taxes on such property. If a given lease is rejected, the trustees are adequately protected by an order of the type suggested, in the absence of a showing that the value of the property of any given underlier is less than the amount of the taxes to be paid thereon. There has been no such showing in the present case, and in this respect the underliers in the present case are in a much stronger position than are the underliers involved in the Webster & Atlas National Bank case (*Webster & Atlas Nat. Bk. v. Palmer*, 111 Fed. (2d) 215. Certiorari granted October 14, 1940; 120 October Term, 1940, in this Court.)

VII.

Conclusion.

Under Sec. 124a the trustees are required to pay the state and local taxes assessed in respect of the business of the underliers, and upon general principles they should likewise pay the federal taxes of the underliers so long as they continue to operate the business and properties of the underliers in conjunction with the business and properties of the debtor. All taxes which accrued or became due and payable after the approval of the debtor's original petition should be paid. Such payment should not be made to depend upon a separate ascertainment of the net income derived from the properties of each underlier. No objectionable preference will result from such payments. It is respectfully submitted that the judgment of the Circuit Court of Appeals

Brief for Petitioners.

for the Third Circuit in these proceedings should be reversed and the orders of the District Court affirmed.

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We, the undersigned, join in and adopt the foregoing Brief in behalf of the Citizens Traction Company, Penn Street Railway Company and The Suburban Rapid Transit Street Railway Company, underliers of the Pittsburgh Railways Company.

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I, the undersigned, join in and adopt the foregoing Brief in behalf of the Allegheny Traction Company and Millvale, Etna & Sharpsburg Street Railway Company, underliers of the Pittsburgh Railways Company.

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